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In the Supreme Court of the United States

OCTOBER TERM, 1949

No. 574

PIEDMONT COTTON MILLS, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 23-29) is not officially reported. The *per curiam* opinion of the Court of Appeals (R. 39-40) is reported at 177 F. 2d 148.

JURISDICTION

The judgment of the Court of Appeals was entered on October 12, 1949. (R. 40.) On January 3, 1950, the time for filing a petition for a writ of certiorari was extended to and including February 1, 1950. (R. 41.) The petition for a writ of certiorari was filed on February 1, 1950. The juris-

diction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether, in computing taxpayer's allowance for depreciation for the taxable years 1936 and 1937 under Sections 23(l) and (n), 113(b)(1)(B) and 114 of the Revenue Act of 1936, taxpayer's basis for depreciation should be reduced by the amount of depreciation properly allowable for the fiscal years ended August 31, 1928, through August 31, 1935, as taxpayer contends, or, as this Court, the court below, and the Tax Court have held, by the greater amounts of depreciation claimed by taxpayer and reported for those years, even if the excess of reported over properly allowable depreciation did not offset taxable income.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and Treasury Regulations are set forth in the Appendix, *infra,* pp. 11-15.

STATEMENT

The facts were stipulated (R. 18-22) and were repeated in the Tax Court's memorandum opinion (R. 23-27). They are as follows:

Piedmont Cotton Mills (hereinafter referred to as the "taxpayer") is a Georgia corporation engaged in the manufacture of cotton textiles and has its principal office in the town of Egan, Georgia. It reported income in the amount of $5,926.92 for the fiscal year ended August 31, 1936, and a net

loss of $12,415.74 for the fiscal year ended August 31, 1937. (R. 23-24.)

In its returns for the fiscal years 1936 and 1937, taxpayer deducted depreciation in the respective amounts of $31,562.76 and $30,919.39. In determining the deficiencies here involved the Commissioner disallowed $19,262.17 of the amount deducted for depreciation for the fiscal year 1936 and disallowed $18,123.78 of the amount deducted for depreciation for the fiscal year 1937. (R. 24.)

The controversy relates to the Commissioner's action in computing taxpayer's depreciation base by adding to taxpayer's depreciation reserve as of August 31, 1927, in the amount of $266,426.25, the full amounts of depreciation reported on taxpayer's returns for each of the years ended August 31, 1928, to August 31, 1935, inclusive, aggregating $182,955.97.[1] (R. 24-25, 26-27.) Prior to his investigation of taxpayer's 1936 and 1937 returns, the Commissioner had not questioned the depreciation deductions as reported by taxpayer on its returns for the years 1928 to 1935, inclusive. (R. 27.) In determining the deficiencies against taxpayer for the years 1936 and 1937, the Commissioner used percentage rates of depreciation which are admittedly correct for all the fiscal years 1928 to 1937, inclusive. (R. 25, 26.) The amount of depreciation reported by taxpayer

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[1] Taxpayer does not question the correctness of the depreciation reserve as of August 31, 1927. (See Stip. 5, R. 24-25.)

for each of the years 1928 to 1935, inclusive, was more than the amount properly allowable for each of those years, as shown by the following tabulation which is a part of the stipulation (R. 25):[2]

(1) Fiscal Year	(2) Net Loss After Deducting Depreciation Reported on Returns	(3) Depreciation Reported on Returns	(4) Allowable Depreciation	(5) Difference between (3) and (4)	(6) Increase in Taxable Income
1928	$59,410.62	$ 20,899.28	$ 14,277.90	$ 6,621.38	None
1929	17,051.14	30,295.98	15,626.77	14,669.21	None
1930	45,944.14	24,575.76	16,264.50	8,311.26	None
1931	32,818.32	22,033.44	16,373.32	5,660.12	None
1932	29,563.99	22,033.44	16,452.38	5,581.06	None
1933	5,393.82	22,885.41	16,518.08	6,367.33	$973.51
1934	16,836.43	21,561.54	16,196.68	5,364.86	None
1935	37,072.22	18,671.12	15,972.08	2,699.04	None
Totals		$182,955.97	$127,681.71	$55,274.26	$973.51

If the total excess of depreciation claimed over that properly allowable ($55,274.26) may not be restored to taxpayer's undepreciated balance as of September 1, 1935, then the correct allowable depreciation for the fiscal year 1936 is $12,300.59, and for the fiscal year 1937 is $12,795.61 (R. 27), as the Commissioner determined (R. 24). If the excess for which taxpayer did not receive a tax benefit ($55,274.26 minus $973.51 for 1933, or a net amount of $54,300.75) may be restored to taxpayer's undepreciated base, the correct allowable depreciation for the fiscal year 1936 is $16,346.91, and for the fiscal year 1937 is $16,763.03.[3] (R. 26-27.)

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[2] Column (6) of the tabulation represents the increase which results in taxable income for each year when the depreciation properly allowable, rather than the reported depreciation, is deducted from gross income.

[3] The parties thus assumed that only $973.51 for 1933 offset taxable income. As to the remainder of the excess of reported

The statute of limitations has run on the assessment of any additional tax or the claiming of any refund for each of the fiscal years included in the period beginning September 1, 1927, and ending August 31, 1935. (R. 27.)

On these facts, the Tax Court sustained the Commissioner's determination and held that taxpayer's depreciation base for the fiscal years 1936 and 1937 could not be increased by the amount of excessive depreciation deducted in its income tax returns for the prior years from 1928 through 1935, for which it received no tax benefit in those years. (R. 27-29.) On appeal, the decision of the Tax Court was affirmed *per curiam*. (R. 39-40.)

ARGUMENT

Pursuant to Sections 23 (n), 113 (a) and (b) and 114 (a) of the Revenue Act of 1936 (Appendix, *infra*, pp. 11-12), taxpayer's depreciation base for computing its depreciation deductions for the fiscal years 1936 and 1937, under Section 23 (l) (Appendix, *infra*, p. 11), is the cost of the depreciable property less the depreciation on that prop-

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depreciation over properly allowable depreciation, the Tax Court stated that considering the language of the stipulation, particularly paragraph 7, and the terms in which the issue was stated by the parties, it considered the parties to agree that the amount of excess of "allowed" over "allowable" depreciation in the previous years did not serve to offset income. The Tax Court noted, however, that in three of the previous years (1929, 1933 and 1934) the depreciation reported exceeded the net loss after deducting reported depreciation—a fact which raises the question whether the amount of depreciation deducted for those years served to reduce taxable income. The Tax Court passed this question. (R. 23, fn. 1.)

erty for prior years "to the extent allowed (but not less than the amount allowable)". See also, Treasury Regulations 94, Articles 23(l)-4, 23(l)-5, 23(l)-9, 113(b)(1), and 114-1 (Appendix, *infra*, pp. 12-15). In *Virginian Hotel Co.* v. *Helvering*, 319 U. S. 523, rehearing denied, 320 U. S. 810, this Court held that the depreciation "allowed" for years prior to the taxable year is the amount of depreciation actually claimed by the taxpayer and not challenged by the Commissioner, including any part thereof for which the taxpayer received no tax benefit. That decision therefore requires a rejection of taxpayer's contention in the present case, as the court below held (R. 39-40), and as taxpayer concedes (Pet. 7).

The sole reason urged by taxpayer for the granting of its petition for a writ of certiorari is that the Court should overrule its decision in the *Virginian Hotel* case and "correct its erroneous interpretation of the statute" in that case. (Pet. 7.)[4] The Court has already denied certiorari in three cases in which the petition for a writ of certiorari raised a question as to the correctness or the applicability of the *Virginian Hotel* decision. *Commerce Co.* v. *United States*, 171 F. 2d 189 (C.A. 5), certiorari denied, 336 U. S. 972; *Bank of America*

[4] Taxpayer also asserts that the question involved is of general applicability and of great importance in our tax system (Pet. 18) but, since the question involved has already been decided by the Court, this assertion also necessarily assumes that the Court should overrule its decision in the *Virginian Hotel Co.* case.

Nat. T. & S. Ass'n v. *United States,* 69 F. Supp. 932 (N.D. Cal.), affirmed *per curiam,* 168 F. 2d 399 (C.A. 9), certiorari denied, 335 U. S. 827; *Replier Coal Co.* v. *Commissioner,* 140 F. 2d 554 (C.A. 3), certiorari denied, 323 U. S. 736; see also *Commissioner* v. *Kennedy Laundry Co.,* 133 F. 2d 660 (C.A. 7), certiorari denied, 319 U. S. 770, rehearing denied, 320 U. S. 810.

Most, if not all, of taxpayer's arguments against the result reached in the *Virginian Hotel* case were considered in that case. The arguments with respect to the legislative intent (Pet. 10-12, 14-15) and the principle that an error in a prior tax year may be corrected if it had no effect on taxes (Pet. 15-17) were both urged in the petitioner's brief in the *Virginian Hotel* case (see No. 766, October Term, 1942, Pet. Br. 11-16, 17-19). The arguments as to what the Commissioner does or may do in different factual situations (Pet. 12-14), and as to the administrative practice respecting depreciation deductions (Pet. 11-12; Supp. Br. for Pet. 2-4), were fully covered in the petition for rehearing (pp. 3-9, 17-19) filed in that case.

Taxpayer's remaining argument for overruling *Virginian Hotel Co.* v. *Helvering* consists of the suggestion that in that case the Court may not have considered the factual situation involved in the present case and apparently failed to realize the inequitable and unjustified result of its holding when applied to such facts. (Pet. 7-10, 17.) The argument has as its premise statements (Pet. 7-9)

which in effect constitute an assertion that taxpayer here claimed excessive depreciation in each of the years 1928 through 1935 even though, on the basis of the facts reasonably known to exist at the end of each of those years, it knew or should have known what amount of depreciation was properly "allowable", whereas in the *Virginian Hotel* case the taxpayer claimed, in the prior years, the amount of depreciation which was properly "allowable" to it on the basis of facts then known to exist, the amounts claimed as depreciation being excessive only because of facts subsequently ascertained. Such a factual distinction hardly furnishes a basis for an appeal to equity and justice, and, actually, the stipulations in the two cases do not even afford an adequate basis for taxpayer's assumption that the factual distinction exists. Cf. par. 9 of the instant stipulation (R. 26) with the portion of the stipulation in the *Virginian Hotel* case quoted by taxpayer at Pet. 9, fn. 7. In any event, the Court has already been urged to draw this line, and has declined to review Court of Appeals' decisions that the *Virginian Hotel* rule applies to such a factual situation as taxpayer portrays for itself. In *Commissioner* v. *Kennedy Laundry Co.*, 133 F. 2d 660 (C.A. 7), certiorari denied, 319 U. S. 770, rehearing denied, 320 U. S. 810, the taxpayer had erroneously taken depreciation in the earlier years which was excessive in the light of facts known in those years and, like the taxpayers in the *Virginian Hotel* case and in the present case,

claimed that the excessive depreciation was not "allowed" to the extent for which no tax benefit had been received. The *Kennedy* case was before the Court contemporaneously with the *Virginian Hotel* case, the petition for a writ of certiorari having been filed after certiorari was granted, but before oral argument, in the *Virginian Hotel* case. The petition in the *Kennedy* case urged that the case was on all fours with the *Virginian Hotel* case but also specifically called attention to the difference in facts now emphasized. The Government did not oppose certiorari, but suggested that the Court might wish to withhold action upon the petition until disposition of the *Virginian Hotel* case. The denial of certiorari in the *Kennedy* case just one week after decision in the *Virginian Hotel* case effected a disposition of the *Kennedy* case consistent with disposition of the *Virginian Hotel* case. Petitions for rehearing in both cases were denied on the same day. The Court has also since denied certiorari in another case involving a factual situation similar to that taxpayer assumes for itself in the present case. *Bank of America Nat. T. & S. Ass'n* v. *United States,* 69 F. Supp. 932 (N. D. Cal.), affirmed *per curiam,* 168 F. 2d 399 (C.A. 9), certiorari denied, 335 U. S. 827.

It is fair to say, therefore, that all the reasons now advanced to show the error in the *Virginian Hotel* rule have heretofore been presented to, and considered by, the Court. Petitioner suggests nothing that has not already been canvassed.

CONCLUSION

The decision below is correct under this Court's decision in the *Virginian Hotel* case and no adequate reason is presented for a re-examination of the question there decided. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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MARCH, 1950.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

* * * * *

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23(l)-4. *Capital sum recoverable through depreciation allowances.*—The capital sum to be replaced by depreciation allowances is the cost or other basis of the property in respect of which the allowance is made. * * *

ART. 23(l)-5. *Method of computing depreciation allowance.*—The capital sum to be re-

covered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production. Whatever plan or method of apportionment is adopted must be reasonable and must have due regard to operating conditions during the taxable period. The reasonableness of any claim for depreciation shall be determined upon the conditions known to exist at the end of the period for which the return is made. If the cost or other basis of the property has been recovered through depreciation or other allowances no further deduction for depreciation shall be allowed. The deduction for depreciation in respect of any depreciable property for any taxable year shall be limited to such ratable amount as may reasonably be considered necessary to recover during the remaining useful life of the property the unrecovered cost or other basis. The burden of proof will rest upon the taxpayer to sustain the deduction claimed. * * *

A taxpayer is not permitted under the law to take advantage in later years of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. * * *

ART. 23(l)-9. *Records of depreciable property.*—In order that the verification of depreciation allowances claimed by the taxpayer may be facilitated, depreciation shall be re-

corded on the taxpayer's books, the amount measuring a reasonable allowance for depreciation either being deducted directly from the book value of the assets or preferably being credited to a depreciation reserve account, which should be reflected in the annual balance sheet. * * * Also, the taxpayer's books shall show the basis of the depreciable property and any adjustments thereto * * *. If a taxpayer does not desire to have his regular books of account show all of the factors entering into the computation of depreciation allowances, such factors shall be recorded in permanent auxiliary records which shall be kept with and reconciled with the regular books of account.

ART. 113(b)-1. *Adjusted basis: General rule.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property is the cost of such property * * * adjusted to the extent provided in section 113 (b).

* * * * *

The cost or other basis must also be decreased by the amount of the deductions for exhaustion, wear and tear, obsolescence, amortization, and depletion to the extent such deductions have in respect to any period since February 28, 1913, been allowed (but such decrease shall not be less than the amount of deductions allowable) under the Revenue Act of 1936 or prior income tax laws. The adjustment required for any taxable year or period

is the amount allowed or the amount allowable for such year or period under the law applicable thereto, whichever is the greater amount. A taxpayer is not permitted to take advantage in a later year of his prior failure to take any depreciation allowance or of his action in taking an allowance plainly inadequate under the known facts in prior years. The determination of the amount properly allowable shall, however, be made on the basis of facts reasonably known to exist at the end of such year or period. The aggregate sum of the greater of such annual amounts is the amount by which the cost or other basis of the property shall be adjusted.

* * * * *

ART. 114-1. *Basis for allowance of depreciation and depletion.*—The basis upon which exhaustion, wear and tear, obsolescence, and depletion will be allowed in respect of any property is the same as is provided in section 113 (a), adjusted as provided in section 113 (b), for the purpose of determining the gain from the sale or other disposition of such property, except as provided in article 23(m)-3, relating to depletion based on discovery value, in article 23(m)-4, relating to percentage depletion in the case of oil and gas wells, and in article 23(m)-5, relating to percentage depletion in the case of coal mines, metal mines, and sulphur mines or deposits.

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